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MEMORANDUM

CHINA-TAIWAN TRADE

Trade between China and Taiwan remains economically insignificant to each side. The two-way exchange--all indirect--totaled some \$330 million in 1980; more than 95 percent of this trade is conducted through Hong Kong middlemen, with the remainder handled through entrepots in Japan and Singapore. Virtually all the growth in this trade has resulted from China's decision to lift its ban on goods from Taiwan in 1979 and to permit their duty-free entry. Occasional reports of direct business contacts have never been substantiated. [REDACTED]

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Whereas Beijing has publicized this indirect connection as part of its reunification bid, Taipei has avoided any suggestion that the relationship involves forward movement on Beijing's initiatives, which include the opening of direct trade. Taipei acquiesces to the discreet and limited flow of goods but wants to prevent the trade from moving to a level that would hint of economic dependence on China. Under present policies, growth prospects for trade depend largely on China's willingness to import more Taiwanese consumer goods. Like its willingness to accept unofficial contacts with Beijing in sports, academics, and other areas, Taipei's attitude toward carefully limited trade may reflect a longer term hope that its indirect ties will promote an eventual acceptance of the status quo between China and Taiwan.

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Recent Trends

Despite a sharp increase in China's exports worldwide, re-exports of Chinese goods to Taiwan--mostly specialty goods such as Chinese vegetables, teas, hog bristles, and herbal medicines--have been flat over the past several years (see

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figure). Some Taiwan goods are re-exported from Hong Kong and are involved in the distribution of these goods on the island, although it is unclear whether their role reflects corruption or tacit support from higher levels. [REDACTED]

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In 1980, China's re-exports amounted to \$80 million--less than 0.5 percent of both total Chinese exports and total Taiwan imports. Small amounts of mainland goods have trickled into Taiwan since 1949, mainly because the island authorities have been unable or unwilling to stop the import of politically nonsensitive goods. Many of these goods are relabeled in Hong Kong to disguise their true origin from Taiwan customs officials. [REDACTED]

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Until Beijing lifted its ban in 1979, however, virtually no Taiwanese goods reached the mainland. At that time, Beijing also decided to let local and provincial enterprises engage directly in foreign commerce, bypassing the central Ministry of Foreign Trade. This decision resulted in an upsurge in local Chinese demand for foreign goods. Guangdong Province quickly took advantage of its proximity to Hong Kong to purchase consumer goods--including Taiwanese televisions, radios, cassette tape recorders, hand calculators, and textiles, which were readily available in the Hong Kong market. In 1980, imports of Taiwanese products reached about \$250 million--about 1 percent of total Chinese imports and Taiwan exports. [REDACTED]

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The downturn in Chinese imports of Taiwanese goods since the first of this year probably stems in part from Beijing's move at that time to recentralize trade and to limit purchases of consumer goods by local enterprises. Beijing also ordered all local enterprises that held foreign exchange balances with banks in Hong Kong to remit those funds to the Bank of China by 1 March. These decisions resulted in a sharp downturn in all Chinese purchases of consumer goods in Hong Kong. Contrary to speculation in the Hong Kong press about removing the duty-free status of Taiwan-made products, the Chinese Customs Administration has denied making any changes in the tariff treatment accorded those goods. [REDACTED]

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Government officials in Taiwan cannot prevent Hong Kong middlemen from re-exporting Taiwan's goods, and Taipei has turned a blind eye to the activity of local firms involved in the indirect trade. Taiwan's exports to China are produced by [REDACTED] 25X1 companies owned by native Taiwanese, who dominate the private sector. The government, dominated by mainland Chinese, has done little more than order the companies to behave discreetly. [REDACTED]

There have been a few recent signs, however, that Taipei may take a more realistic public posture on the issue. In September, Premier Sun Yun-hsuan publicly said that although such trade was illegal, Taiwan cannot control what happens to its goods once they have been sold abroad. Sun's statement no doubt pleased the Taiwanese business community, which would like to increase

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... to China. In fact, a Taiwan official recently raised the question in the legislature. He pointed out that Taiwan--with an economy that depends on exports--should take advantage of the China market. [REDACTED]

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Whether mainland Chinese businessmen on Taiwan hold similar views is unknown, but at least one state-owned corporation controlled by the mainlanders evidently is involved in the indirect trade. Last year, the China Shipbuilding Corporation signed a \$50 million contract to build two 58,000-ton bulk carriers for a PRC-controlled Hong Kong company. Besides profit, Taiwan's motivation for this sale is unclear. [REDACTED]

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The only direct trade between China and Taiwan is conducted by fishermen who smuggle goods across the Taiwan Strait. Both sides have tried to stifle this trade, but neither appears overly concerned. This illicit trade remains miniscule, and the number of arrested fishermen has shown little fluctuation since 1979. [REDACTED]

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Prospects

In the short-run, indirect trade between China and Taiwan will depend on Beijing's willingness to permit local enterprises to engage directly in trade with foreigners. The Chinese appear to be moving closer to a decentralized trade policy that actively promotes initiative at the enterprise level. This may foster a renewed interest in purchases of consumer goods. For its part, the Taiwan government shows little inclination to ease restrictions on imports of mainland products. [REDACTED]

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The long-term prospects for trade will depend on political relations between Taipei and Beijing. As part of its reunification initiative, China has proposed that the two sides open direct communications, postal links, and direct trade before beginning political talks. Taiwan has steadfastly opposed even the preliminary steps to that end. Taipei is concerned that direct contacts such as trade might be construed as a sign that it is willing to move toward negotiations, and in the process, toward reunification on Beijing's terms. [REDACTED]

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Chinese reunification proposals pose a dilemma for Taiwan. Although they treat Beijing's proposals as propaganda, officials on Taiwan also understand that there are political liabilities in failing to respond at all. Taiwan's contacts with China in sports, academics, scientific research and other international meetings demonstrate Taipei's recognition that it must respond to Beijing's overtures in limited ways, albeit while continuing to reject categorically Chinese reunification proposals. Despite Taipei's disclaimers of endorsement, such contacts have increased dramatically in the last few years. [REDACTED]

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Taiwan is not only a free market economy, but also a series of bilateral tensions, but, with the political tensions imposed by the political position, almost certainly wants them to continue and even expand. In contrast to the Chinese goal of using trade as an entre to reunification, officials in Taipei apparently hope that such moves will bring a modus vivendi and ultimately China's acquiescence to de facto independence for Taiwan--a situation described by one official on Taiwan as comparable to the two Germanys. [REDACTED]

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In strictly economic terms, both China and Taiwan could see some advantages in a direct trade relationship. In the unlikely event that such trade were permitted, China could provide Taiwan with some crude oil, coal, nonferrous metals, paper, rubber products, pharmaceuticals, and plastics--items that Taiwan currently imports. Taiwan, moreover, could supply China with synthetic textile fabrics, plywood and other wood products, cement, and some types of machinery. [REDACTED]

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In many ways, however, the two economies would also be in direct competition. Both countries export many of the same types of foodstuffs, textiles, and light consumer goods while importing grains, fertilizers, cotton, chemicals, steel, machinery, and equipment. Like some countries in Southeast Asia, Taiwan would have reason to fear that many consumer goods--currently a major share of its exports and the mainstay of its economy--would be subject to direct competition from the mainland. In short, a projected balance sheet of direct trade would be insufficient to induce Taipei to alter its position on dealing with Beijing for economic advantage alone. [REDACTED]

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Quarterly CHINA-TAIWAN TRADE THROUGH HONG KONG

Million US \$

